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MINUTES OF THE BOARD OF SUPERVISORS
COUNTY OF LOS ANGELES, STATE OF CALIFORNIA

Violet Varona-Lukens, Executive Officer
Clerk of the Board of Supervisors
383 Kenneth Hahn Hall of Administration
Los Angeles, California 90012

Auditor-Controller
Chief Administrative Officer
County Counsel
Director of Personnel

At its meeting held September 28, 2004, the Board took the following action:

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The following item was called up for consideration:

Chief Administrative Officer's joint recommendation with the Director of Personnel to approve the proposed premium rates for County sponsored plans as follows: a) medical and dental rates for represented employees for the period of January 1, 2005 through December 31, 2005, b) medical and dental rates for non-represented employees for the period of January 1, 2005 through December 31, 2005, c) rates for dependent life insurance for all employees for the period of January 1, 2005 through December 31, 2006, and d) continue existing premium rates for the Short-Term Disability, Long-Term Disability (LTD) and LTD Health Insurance Plans; and approve introduction of ordinance; also approve the following related actions:

Instruct County Counsel to review and approve appropriate contracts with Blue Cross of California and Blue Cross Life and Health Insurance Company, Connecticut General Life Insurance Company and CIGNA Healthcare of California, Inc., Kaiser Foundation Health Plan, Inc., PacifiCare of California and PacifiCare Life & Health, Delta Dental Plan, Private Medical-Care, Inc., SafeGuard Health Plans, Inc. and their successors or affiliates, as necessary, for the period of January 1, 2005 through December 31, 2005; and instruct the Chairman to sign contracts;

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24 (Continued)

Instruct County Counsel to review and approve an appropriate amendment to the life insurance contract with Life Insurance Company of North America and its successors or affiliates, as necessary, incorporating the dependent life insurance rates for the period of January 1, 2005 through December 31, 2006; and instruct the Chairman to sign amendment;

Approve proposed premium rates and benefit coverage changes for the Association for Los Angeles Deputy Sheriffs, Inc., the California Association of Professional Employees plans and the Los Angeles County Fire Fighters Local 1014 Health and Welfare Plan, for the period of January 1, 2005 through December 31, 2005;

Approve adjustment in minimum County contribution under the MegaFlex and Flexible Benefit Plans from $770 per month and $559 per month, respectively, to $810 per month and $591 per month, respectively, effective beginning January 1, 2005;

Instruct the Auditor-Controller to make all payroll system changes necessary to implement the changes recommended to ensure that all changes in premium rates are first reflected on pay warrants issued on January 14, 2005.

Blaine Meek, Counsel for the California Association of Professional Employees MEBA, ASL-CIO; Paul Roller, Chair of the Coalition of County Unions; Sue Cline, Member and Ralph Miller, President of the American Federation of State, County, and Municipal Employees, Local 685, ASL-CIO, addressed the Board. Written correspondence was presented.

David E. Janssen, Chief Administrative Officer, Sharon Harper, Chief Deputy Administrative Officer and Michael J. Henry, Director of Personnel responded to questions posed by the Board.

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Supervisor Antonovich made the following statement:

> "Currently the County of Los Angeles, when negotiating with Kaiser Permanente, is unable to get access to all information relating to proposed rate increases. On September 10, 2004, Kaiser Permanente presented a letter which outlines their commitment to working with the County in establishing a process that results in a greater understanding of the health care trends within the County/Kaiser Permanente members. The commitment of Kaiser to collaborate with the County must be included as part of contract language when negotiating our contracts for all County employees. It is my understanding that the State of California has included language which allows them to audit Kaiser Permanente's books when validating rate increases for State employees. A provision similar to the State of California must be included for the County."

Therefore, Supervisor Antonovich made a motion that the Board direct the Chief Administrative Officer and the Director of Personnel to incorporate language in all County contracts with Kaiser Permanente which allows the County to access all information pertaining to rate increases which provides the County with the mechanism to audit rate increases put forward by Kaiser Permanente.

Supervisor Burke made the following statement:

> "Considering the increasing cost of employee health coverage, it is necessary for the County's health plans to justify their increase in premiums each year."

Therefore, Supervisor Burke made a suggestion that Supervisor Antonovich's motion be amended to instruct the Chief Administrative Officer and the Director of Personnel to request detailed information on the need for future rate increases for all County-sponsored plans, and justify those rates, and provide a review of associated costs incurred by Los Angeles County.

Supervisor Knabe made a suggestion that Supervisor Burke's amendment to Supervisor Antonovich's motion also include an instruction to the Chief Administrative Officer and the Director of Personnel to request Kaiser Permanente to open their records and provide detailed information to the County in terms of their current premium rates, a justification of these rates, and a review of associated costs incurred by Los Angeles County, and report back to the Board in 30 days.

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Discussion ensued amongst the Board members about implementing a freeze to new hires to the Kaiser Permanente Health Plan for Coalition of County Union employees. It was concluded that the Board will consider this matter in the event Kaiser doesn't provide detailed information in terms of their 2005 premium rates.

Further, the Board discussed with the Director of Personnel extending the open enrollment period for employees to select their benefits which is scheduled to begin on October 1, 2004. A compromise was reached to extend the enrollment period by 15 days to provide time for the Chief Administrative Officer and Director of Personnel to report back to the Board regarding the issues involving the premium rate increases of Kaiser Permanente.

Therefore, after lengthy discussion, on motion of Supervisor Burke, seconded by Supervisor Antonovich, unanimously carried, the Board approved the attached joint recommendations of the Chief Administrative Officer and the Director of Personnel and took the following additional actions:

1. Instructed the Chief Administrative Officer and the Director of Personnel to incorporate language in all County contracts with Kaiser Permanente which allows the County to access all information pertaining to rate increases which provides the County with the mechanism to audit rate increases put forward by Kaiser Permanente;

2. Instructed the Chief Administrative Officer and the Director of Personnel to request detailed information for all County sponsored plans, on the need for future rate increases, a justification of those rates, and a review of associated costs incurred by Los Angeles County;

3. Instructed the Chief Administrative Officer and the Director of Personnel to request Kaiser Permanente to open their records and provide detailed information to the County in terms of their current premium rates, a justification of these rates, and a review of associated costs incurred by Los Angeles County, and report back to the Board in 30 days; and

4. Instructed the Director of Personnel to extend for 15 days the 30-day open enrollment period scheduled to begin October 1, 2004, for employees represented by the Coalition of County Unions, only.

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Attachment

Copies distributed:
Each Supervisor

(ALSO SEE NO. 32 THIS DATE)

County of Los Angeles
CHIEF ADMINISTRATIVE OFFICE
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DAVID E. JANSSEN
Chief Administrative Officer

June 17, 2005

To: Supervisor Gloria Molina, Chair
Supervisor Yvonne B. Burke
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: David E. Janssen
Chief Administrative Officer

Michael J. Henry
Director of Personnel

FINAL REPORT ON MATTERS RERGARDING ITEM 24 ON THE SEPTEMBER 28, 2004 BOARD AGENDA

At your Board's September 28, 2004 meeting, the Board approved the recommendations of the CAO and Director of Personnel relating to proposed premium rates for County and union sponsored health, dental and life insurance plans for calendar year 2005 (Agenda Item 24). Your Board also ordered that additional actions be taken (Attachment A), including a review of Kaiser's 2005 rates.

This report (1) describes the actions taken to implement the Board's orders, (2) responds to key issues regarding health, dental and life insurance rates for 2005 and (3) reviews options for future action.

Part I -- Executive Summary

Part I, the executive summary, summarizes actions taken in response to the Board's orders, our key findings and conclusions. These are reviewed in greater detail in Parts II, III and IV and in the attachments to this report.

1. The September 28, 2004 Board orders have been implemented as described in Part II. The audit provision of the Kaiser contract was amended and is effective for 2005. The 2005 enrollment period for Coalition of County Union (CCU) members was

extended to November 15, 2004. A review of Kaiser's 2005 rates (Attachment F) has been completed by the County consultant, Mercer Human Resource Consulting.

The Mercer review of Kaiser rates for four plans included Local 660 and the CCU plan, the plan for County non-represented employees, and the plans of two large outside public agencies. It confirmed the inpatient and outpatient components of Kaiser's rate development, but could not confirm the pharmacy component. Kaiser disagrees with Mercer's pharmacy finding (see Attachment F for details).

Additional requirements for review and reporting were incorporated into planning of the rate renewal process for 2006 rates. The 2006 process has begun and results will be reported to your Board, as requested, when proposed 2006 rates are presented to you in late summer.

2. Longer term issues related to cost containment, including the Kaiser cost picture, and what measures are available to influence costs for Kaiser and other County health plans, are described in Part III. High Kaiser costs are part of the larger picture of spiraling health costs. Health cost trend is part of a national picture too large in scope for a single employer to control. However, employers do have limited control. Careful due diligence helps the County to stay "within the market." Cooperation with other employers may give the County more bargaining leverage to deal with an ever shrinking group of dominant health market carriers.

Part of the Kaiser cost picture is within its exclusive control and can not be affected by employer measures. However, there are steps which we can take to slow the rate of increase and help make health care more affordable to both the County and its employees. Ineffective use of Kaiser and other carriers' resources by County employees and adverse selection (flight of healthy low risk employees to less expensive plans) are examples of phenomena that can be influenced by joint carrier and County action. The County and its unions have selectively used measures such as risk shifting, cross subsidization, economic incentives and employee education to help make health insurance costs more affordable.

Currently, County management and unions are working with Kaiser and PacifiCare to identify key disease processes, care systems, employee resource use, and other issue driving costs, and to develop and deliver targeted education and other measures to mitigate cost and improve services. The Local 660/County management initiative is at an advanced stage.

3. County options are described in Part IV. Kaiser is a popular choice for many County employees, but if the disparity between Kaiser rates and those of other plans continues

to increase, at some point in the future it may not be in the interest of the County family to continue its relationship with Kaiser. Without doubt, freezing new enrollment in the Kaiser Plan would cause both aging of the Kaiser population and adverse selection and would, therefore, lead to higher Kaiser rates; so this action is not recommended.

In accordance with the Board's order we are augmenting due diligence. In addition, we have expanded efforts to work with carriers and County unions to mitigate health costs.

Part II -- Implementation of Board Orders

The following action was taken to implement the Board's orders:

1. Access to Kaiser rate increase information with a mechanism to audit rate increases put forward by Kaiser Permanente. Past contracts with Kaiser included the County's standard audit conditions. Additional language (Attachment B) was incorporated in the Kaiser contract for 2005 to implement the order. This language was reviewed and approved by the County Counsel.

2. Request detailed information for all County sponsored plans, on the need for future rate increases, a justification of those rates, and a review of associated costs incurred by Los Angeles County. For many years the County, with the assistance of its consultant, and with union input where appropriate, has conducted an annual, formal due-diligence review of proposed health, dental and life insurance rates, which is based on "best practices." As indicated in the September 28, 2004 Board letter, the due diligence process leading to the 2005 recommended rates produced savings from initial carrier rate proposals of $12 million.

The starting point of the due diligence process is the Request for Rates (RFR), which requires each carrier to supply comprehensive carrier specific information to support proposed rates, document compliance with rigorous performance standards, and comply with County contracting requirements. The RFR results are intensively reviewed and critiqued by County benefit consultants and actuaries, union consultants, County staff and labor-management committees. Carriers are required to explain all inconsistencies and omissions.

The strength of the County bargaining position stems both from the intensive County and union scrutiny that carrier rate proposals get, and from the certainty that if prices are too high, or service standards are not met, employees may migrate to competing County or union sponsored plans. The weakness of the current process is that carriers know that non-renewal of their contracts is seldom an option because current carriers and benefit levels are "locked in" by our fringe agreements with County unions.

To strengthen due diligence this year and beyond, we are broadening the search for cost effective alternatives and will provide improved documentation of due diligence to your Board. In addition, to provide a better planning platform for future years we have commissioned our consultant, Mercer Human Resource Consulting, to perform a risk analysis of County sponsored health plans to identify ways to get better value from the benefit dollar.

3. Request Kaiser Permanente to open their records and provide detailed information to the County in terms of their current premium rates, a justification of these rates, and a review of associated costs incurred by Los Angeles County, and report back to the Board in 30 days. Our report to the Board on 2005 Kaiser rates was based on all of the standard due-diligence plus an additional review of a small top to bottom sample of one of the many clinical diagnoses upon which Kaiser's rate development is based. While we had some confidence that Kaiser's rates were reasonable, our consultant, Mercer, could not render an unqualified professional opinion that the Kaiser rates were either justified or unjustified based on a small sample.

We retained Mercer to provide the County with an opinion of whether the Kaiser rates for 2005 are justified or unjustified. The final Mercer report and responses to the findings of that report by Kaiser and Local 660 are attached (Attachment F). Report findings were discussed with the Coalition of County Unions, but the Coalition did not respond to the report.

Mercer did a top-to-bottom review of a large data sample from four plans, including the County union plan, the County non-represented employee plan, and the plans of two large outside public employers. The goals of the review were to determine if (1) the 2005 Kaiser rates are accurately computed and consistently rated for all plans and (2) logical reasons for differences in the rates among the four plans could be identified. With one notable exception, the Mercer report finds that the Kaiser rates are accurately computed and consistently rated for all plans. Mercer believes that Kaiser's pharmacy rate is not fully justified based on data supplied by Kaiser, a finding that is disputed by Kaiser. In addition, the Mercer report finds that elevated use of Kaiser outpatient and pharmacy resources by County employees is a primary contributor to the difference in rating compared to the other plans reviewed. For the details of Mercer's findings please consult the attached report (Attachment F).

4. Extend for 15 days the 30-day open enrollment period scheduled to begin October 1, 2004, for employees represented by the Coalition of County Unions, only. As directed by your Board, we extended the fall enrollment period for Coalition employees to November 15 and notified those employees of the extension. The purpose of the extension was to let employees represented by the Coalition change

plans if they so chose. Some employees did change plans as shown in the attached enrollment statistics for 2005 (Attachment D).

Part III -- Issues Raised During the Review of Kaiser Rates

During the 2005 rate renewal process, the Board review and the subsequent Mercer review of Kaiser records, some key questions were raised: why does Kaiser cost so much, is the cost justified, how can these costs be managed, what methods are effective in doing so, and what are the County's options? The first questions are covered below. We will comment on the last question, County options, in the final section of this report.

High Kaiser cost

For the past five years Kaiser has been the highest priced County health maintenance organization (HMO) plan. Kaiser's relatively high cost compared to competing HMOs appears to have four components: a much different business model with higher internal costs (see attachment E for details), greater County member use of some Kaiser health resources (see Attachment F for details), some other underlying health care delivery factors that can drive cost, and adverse selection (i.e., healthy members flee to a cheaper plan).

--*Different business model.* Kaiser's business model is commonly labeled the "staff HMO" and today it is the only major organization of its kind in the nation. While it insures the cost of providing health service to customers, Kaiser is not an insurance company; it is a hospital and clinic company that employs 143,000 doctors, nurses and other employees to provide health services directly to 8.4 million member patients nationally. Kaiser's HMO competitors are insurance companies who contract with hospitals, doctors and other health practitioners to provide health services to subscribers. As seen in Attachment E, Kaiser's insurance company competitors may have a competitive advantage in controlling costs due to business model differences.

--*Ineffective County use of Kaiser resources.* Each year Kaiser has calculated an average premium rate for all customers called the "community rate," which is based on average resource use and then calculates a "Rate Adjustment Factor" (RAF) to increase or decrease the rate for individual customers based on the customer difference from average resource use. The 2005 community rate for large plans, such as the County union plan, was 8.2%, and the RAF for the union plan was 5.1%, a total of 13.3%.

The Mercer review sampled more than half of total patient encounters during the survey period by concentrating on high volume and high cost inpatient and outpatient services

to test if County union members use more services than other plans. Total use of inpatient services was similar to the community. However, the Mercer review indicates that union employee use of Kaiser emergency room and pediatric out-patient resources was much higher than the community rate average and accounts for much of the RAF levied on the County's union plan. On the other hand, the pharmacy contribution to the RAF appears to be attributable primarily to rising drug prices on drugs prescribed for union plan employees.

--*Underlying factors.* The Mercer review documents the bare financial facts: high resource use of specific kinds and drug trends for the union population lead to a premium rate that is higher than the community rate. The review focused on the reported utilization. It does not investigate why there are more emergency room visits or pediatric encounters, or why those encounters consume more resources. The response of Local 660's consultant to the Mercer review deals extensively with this issue. Coalition of County Union representatives have raised similar questions. For example, issues such as disease prevalence (it can differ among populations), demographic differences (does the union plan population have more young children?), employee difficulties accessing appropriate care and easy access to disease specific services can influence outcomes. Kaiser proposed to explore and resolve these and other issues in the framework letter which was attached as Exhibit VI to the September 28, 2004, rate recommendations (appended to this report as Attachment C). County management, Kaiser, and County unions have started to explore and resolve Kaiser resource use issues and underlying factor problems in a series of monthly meetings which may extend through next spring.

--*Adverse Selection.* One common underlying cost factor when employees have a selection of competing health plans is adverse selection. As a rule of thumb, the least healthy 15-20% of members in any health plan account for 80% of plan costs. Difference in premium cost over time can lead to flight of healthy less costly employees to the cheaper plan. Adverse selection, or the concentration of less healthy employees in the more expensive plan, drives the cost of the expensive plan up further. Because adverse selection may be contributing to the price difference among County plans, including the Kaiser plan, but is impossible to quantify without expert analysis, we have asked Mercer to perform a comparative risk analysis of County sponsored health plans to be completed this fall.

--*Justification of Kaiser 2005 Premium Rates.* The Mercer review finds that the out patient and inpatient components of the Kaiser rates for the four plans reviewed are justified. However, using factors and data provided by Kaiser, Mercer was not able to duplicate Kaiser's pharmacy rate for the four plans it evaluated. Kaiser used its own proprietary method to calculate rates for the pharmacy component. Kaiser indicated

that their rating method for pharmacy is not consistent across large employer groups and varies by benefit level. The additional material Kaiser offered to disclose did not reconcile the difference in results observed by Mercer. The impact on the County union plan, as a percent of total premium, is 0.3% and for the County management plan it is 1.3%. The pharmacy difference when looking at the pharmacy component in isolation is larger. This difference in results is troubling and thusly will be a bargaining point and point of contention in future rate negotiations with Kaiser.

Health Plan Cost Containment

Health cost inflation is part of a long term trend that affects all County health plans, not just Kaiser, and indeed affects all health plans nationally. Health inflation is a national challenge fueled by capital investment, product development, industry compensation structures, new technology, other structural costs, and by rising demand and consumer expectations. Meanwhile, concentration of production and services (including hospitals and health insurance carriers) in fewer and fewer hands means less bargaining power for customers. To quantify the impact, health care has grown to at least 12% of Gross Domestic Product (GDP) nationally, costing more than other necessities such as food, clothing or housing. Total County insurance benefit premium costs are approaching $625 million annually, and health plan costs (not including dental or life insurance) are $556 million of that. Unchecked, County insurance benefit costs could grow to almost $900 million annually by 2009.

The overall market conditions creating spiraling health care cost trends, while very worrisome, are beyond the control of a single employer such as the County, and beyond the scope of this report. This report focuses on County-specific opportunities for slowing trend, while containing and managing insurance costs within a reasonable current market range.

Plan level management methods. There are some obvious choices to manage employer costs: (1) test the market from time to time through the RFP process, (2) with consultant supported due diligence, effectively re-negotiate annual premium renewals of existing contractors, (3) redesign or trim benefits, (4) shift costs to employees, or (5) capitalize on new developments in the market. Because overall health cost trend is a national phenomenon beyond the County's control, of necessity the emphasis should be to contain cost increases within a reasonable range.

Cost containment opportunities are constricted by availability, stakeholder commitments, and novelty. Our consultants advise that there are no more than 6-8 players with the capacity to efficiently serve plans on the County scale. We already do business with most of them through County and union sponsored arrangements. Our

MOUs with County unions have maintenance of benefit provisions which preclude benefit changes and unions resist cost shifts to employee members. Legislation and cost pressures have recently introduced new ideas such as health savings accounts and high efficiency health provider networks (as an addition or alternative to current broad provider networks) to the mix. How widely they will be adopted as solutions remains to be seen. Hopefully, the comparative health plan risk analysis study now being performed by Mercer may point the way to further means to organize our health insurance program to contain costs.

Employee level management methods. There are less obvious methods to keep health insurance premiums affordable by shifting costs among employees, or by influencing employees to better manage their own care. As seen below, County management and labor have cooperated in the past to shift costs preferentially between high risk and low risk employees and to cross subsidize health plans by shifting costs from one plan to another. Management and labor have recently worked to improve employee economic incentive to use health resources wisely and to promote efficient employee use of health resources by using a combination of health delivery issue analysis and issue focused health education.

--*Shifting costs among employees to reduce premiums.* As indicated earlier, the least healthy 15-20% of health plan members who are at highest risk incur most of a health plan's costs. Shifting costs by increasing deductibles or out-of-pocket expense limits has the practical effect of charging less healthy high risk employees a larger share of total health costs and healthy low risk employees less, while keeping premiums low. Management and labor collaborated to use this tool to help stabilize premiums of the former PacifiCare POS Plan.

Cross subsidization charges employees in a low cost plan a little more, so that premiums of another plan in death spiral (a plan losing members rapidly as healthy members flee high premiums) can be made affordable. For some years, with the collaboration of management and labor, the CIGNA HMO has been subsidizing the CIGNA POS and PPO offerings which are both in a death spiral. Without cross subsidization, the CIGNA PPO premium would exceed $30,000 per year at the family level.

--*Using incentives to improve resource use.* Many experts believe that applying copays to health plans, as an incentive for employees to chose health resources wisely, is a effective cost reduction measure that can produce a win for employees. The actual cost of an emergency room visit is 10 to 15 times the cost of the typical medical office visit ($100 versus $1,500), so it is not a good idea for patients to use them interchangeably, but some do. Patented brand name drugs are much more expensive

than generic drug equivalents that are equally effective. Spurred on by the active marketing of drug companies, many patients press their doctors to prescribe the more expensive brand name drug. Last year, Kaiser offered a 2.4% reduction of its proposed 13.3% premium increase as a credit in exchange for (1) an increase in emergency room copay from $5 to $50 dollars, and (2) a change in pharmacy copay charges from $5 for all drugs, to $5 for generic drugs and $10 for brand name drugs. Our consultant, Mercer, calculated that the additional copays would cost $1.6 million and the premium reduction would be $4 million for Local 660 members, a savings of $2.4 million to employees in the first year. The Options Plan (Local 660) labor-management committee, BAC, accepted the offer.[1] The emergency room copay for the Kaiser non-represented employee plan was also increased to $50 generating, a savings.

--Using education to improve resource use. To be effective as a health cost reduction measure, employee education must be targeted selectively to steer the 20% of employees with the most costly health care needs to voluntarily use appropriate health resources. Such techniques can lead to better outcomes and preventative care that slows the progress of disease and holds down costs, especially of chronic diseases. Last year the Options Plan (Local 660) labor-management committee, BAC, adopted cost mitigation goals and objectives (CMGO) to be applied to the Options Plan health carriers, PacifiCare and Kaiser. CMGO aims to determine the chief cost drivers of each carrier by measuring and analyzing disease prevalence, identifying employees with high prevalence diseases requiring high cost treatment, identifying carrier resources to effectively manage those high cost diseases, steering employees to those resources through targeted education, and measuring the impact of the process on cost. This is a multiyear process and outcomes will not be obvious for several years.

--No best way. There is no one best way to solve all health plan cost containment and management problems. The best way usually is the way that fits the specific situation best. Kaiser currently does not offer deductibles or out of pocket expense limits as a plan feature to clients and there is no opportunity for cross subsidization. Accordingly, adjustment of copays and targeted employee education programs are the available options. Kaiser sees all of its company owned facilities as equally capable, cost effective and, with some limited exceptions, does not contract with other providers in the County service area, so new ideas such as high efficiency networks (provider networks limited to high quality, lower cost providers) are not feasible. Such networks are now being offered by some other plans.

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[1] The Kaiser premium rate increase was 13.3% for County union plans. The credit for Local 660 benefit changes was equivalent to 2.4% and Kaiser offered an additional customer service credit of 1.6% resulting in a net increase for Local 660 members of 9.3%.

Part IV -- County Options

Kaiser is the highest cost option HMO available to County employees and dominates the staff HMO market as the only significant player. A lower cost HMO option is available to every employee. Should we be looking for new sources of bargaining leverage with Kaiser? Should the County be thinking about migrating employees to the lower cost plans as a cost containment measure? Or should we work with Kaiser to control costs in that Plan? Some options are evaluated below.

Option: Phase out Kaiser role in providing health care to employees over one or more years. The County has viable HMO alternatives to Kaiser for all employees who are eligible to receive health insurance. Assuming at some point that the County finds Kaiser services are too costly, it might phase out the Kaiser arrangement over one or more years, allowing employees to migrate to the alternative HMOs. Such an action would not be trouble free. As pointed out above, union fringe MOUs require the County to retain Kaiser through 2006 and the unions may insist on retaining that requirement in the successor agreements. The Kaiser plans are preferred by 100,000 employees and their dependents, and elimination of the Kaiser option might be met with resistance even though Kaiser costs more. Finally, elimination of the Kaiser option would cause other County sponsored plans to re-evaluate their rates due to the large influx of employees coming into them. Assuming that Kaiser's higher prices are attributable to adverse selection and to more intensive resource use by County employees than the average of its book of business, not just business model differences, rates of the receiving plans would go up. Assessment of the real situation and the potential adverse selection issue will be completed this fall.

Option: Freeze Kaiser enrollment until costs go down or the Plan dies due to reduced enrollment. The principal reason we did not recommend freezing new Kaiser enrollments, as a tactic to force Kaiser to lower rates, is that it would be ineffective and harmful to employees. A better option may be to let employees decide for themselves. Apparently, due to employee recognition that Kaiser prices are higher, over one thousand Local 660, Coalition, and non-represented subscribers switched to other plans in last fall's enrollment (see Attachment D). With dependents this is equivalent to the loss of over 2000 members for Kaiser.

Mercer and we have observed Kaiser behavior over many years. Kaiser's unique corporate rating policy is established in the early spring of each year. Kaiser's underwriters have no authority to reduce the rates produced by that policy. Only on very rare occasions has Kaiser made marketing decisions to reduce rates for an employer. This is because changing policy for one customer could, in Kaiser's, view

lead to a demand by other Kaiser customers to be re-rated and put a significant part of Kaiser's revenue stream at risk.

Then what would be the outcome of a freeze on enrollment of new hires or transfers to Kaiser? It is likely that Kaiser rates would go up and rates of the other carriers might go down driven by the process of adverse selection. The Kaiser population is an aging group. Older persons are known to use health resources more than younger people, and greater health resource use leads to higher costs. An enrollment freeze would stop the flow of younger healthy people into the Kaiser group and shunt them into other health plan options, increasing the average age and premium cost for Kaiser subscribers. In addition, healthy members of the Kaiser Health Plan will leave as plan costs rise, thereby beginning a classic death spiral of rising premiums and declining population.

Option: Pool resources with other employers to moderate Kaiser prices. Kaiser has no staff model HMO competitors in California, enjoying a dominant position in that health care market niche in the State. This gives Kaiser a significant bargaining advantage. It has been suggested that the County explore with other large employers ways to help Kaiser moderate its rates through joint employer action. We have begun to explore opportunities for inter-employer cooperation.

Option: Kaiser framework proposal and beyond. In the Board letter which your Board approved on September 28, 2004, we included a proposal (Attachment C to this report) which Mercer and we negotiated with Kaiser to serve as a framework for cost containment of future Kaiser premium rates. The framework was intended as a starting place which initially would emphasize completion of the Mercer actuarial review of 2005 rates. It also proposed a review of Kaiser disease management processes and results to help structure service delivery and employee use of services to better use Kaiser resources, improve employee education and reduce costs. The Mercer review results are appended to this report. County managers, County unions, and Kaiser are now meeting on a regular basis to implement the framework proposal and explore CMGO. Further, Kaiser has told us that it will provide a rating option which is based on the direct cost of providing services to select customers as early as the 2007 premium year. We propose to explore that option with Kaiser too, when it becomes available.

The process to obtain and evaluate premium rate proposals for 2006 is underway and will be carried out as your Board directed and as described in this report. If your Board would like to explore further action, please contact us.

If your staff has any questions regarding details of this report, they may contact Frank Frazier of the CAO, at (562) 691-4560, or Marian Hall of the DHR, at (213) 738-2255.

DEJ:MJH
WL:FF:MLH:df

Attachments

c: Executive Officer, Board of Supervisors
County Counsel
All Department Heads
Local 660, SEIU
Coalition of County Unions
Kaiser Permanente